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E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: FINANCIAL TIMES WORLD BANKING CONFERENCE

REF: NEWMAN-AMMERMAN CONVERSATION

SUMMARY: FT ANNUAL WORLD BANKING CONFERENCE, FEBRUARY 27-28, HEARD U.K. GOVERNMENT OFFICIALS (HAROLD LEVER AND KIT MCMAHON FROM THE BANK OF ENGLAND) AS WELL AS ITALIAN AND IRANIAN CENTRAL BANK OFFICIALS EXPRESS CRITICISM OF THE FLOATING EXCHANGE RATE REGIME. THEY DID NOT CONSIDER FLOATING DESERVED TO BE CALLED A MONETARY SYSTEM. PRIVATE BANKERS BELIEVED CONSIDERABLE PROGRESS MADE BY COMMERCIAL BANKS IN ASSESSING RISK IN TODAY'S ENVIRONMENT.
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ORTOLI OF THE EC AND LAHNSTEIN OF THE GERMAN MINISTRY OF FINANCE CAUTIONED AGAINST EXPECTING TOO MUCH FROM ECONOMIC AND MONETARY UNION. SUMMARY DETAILS WERE REPORTED IN THE FT OF TUESDAY, FEBRUARY 28 AND WEDNESDAY, MARCH 1. EMBASSY REPORTING IS DESIGNED TO GIVE INTERESTED READERS A "FEEL" OF THE VIEWS EXPRESSED AND, IN SOME CASES, MORE DETAIL. END SUMMARY.

1. THE LEAD SPEAKER WAS HAROLD LEVER, CHANCELLOR OF THE DUCHY OF LANCASTER, WHO DID NOT CONSIDER DIRTY FLOATING TO BE A MONETARY SYSTEM. INSTEAD OF FLOATING RATES, SOME SYSTEM MUST BE DEVELOPED BASED ON MONETARY AND ECONOMIC COOPERATION. THE SIZE OF THE U.S. DEFICIT, ROUGHLY 1 PERCENT OF GNP, SHOULD NOT CAUSE PANIC. IF COUNTRIES COULD ONLY GET THE MONETARY SYSTEM RIGHT, A DEFICIT OF THAT MAGNITUDE WOULD NOT BE A PROBLEM. A BETTER RECYCLING SYSTEM IS NECESSARY. THE GERMAN AND JAPANESE PERFORMANCE HAS ADDED TO THE BURDEN OF OPEC SURPLUSES. A MAJOR DIFFICULTY IS THAT WE ARE NOT OPERATING AN INTERNATIONAL MONETARY SYSTEM THAT WILL INTELLIGENTLY ACCEPT THE DEFICITS. THE LEVEL OF INTERNATIONAL COOPERATION WHICH CHARACTERIZED THE FIRST 20 YEARS OF THE POST-WAR PERIOD HAS DIMINISHED. IT MUST BE RESTORED OR THE ALTERNATIVE WILL BE A LAPSE INTO PROTECTIONISM.

2. MR. RAINER MASSERA, BANK OF ITALY, SPOKE ON INTERNATIONAL FINANCIAL PROBLEMS. HE REFERRED TO THE PRESENT "NON-SYSTEM" BASED ESSENTIALLY ON PRIVATE BANK LENDING. IT NEED NOT BE UNSTABLE. PRIVATE BANKS HAVE BEEN DEVELOPING SOPHISTICATED MEANS OF ASSESSING EXPOSURE AND RISK, BUT THE PRIVATE BANKING SYSTEM REMAINS THE PIVOT. GREATER IMPROVEMENT IN COLLECTION OF DATA BY OFFICIAL SOURCES THAT COULD BE MADE AVAILABLE TO THE PRIVATE BANKING SECTOR WOULD HELP. IN MASSERA'S VIEW, THE DIFFICULTY IS THAT IN THE EVENT OF A FOREIGN EXCHANGE CRISIS, IT COULD BE SEVERE AND PROVOKE A SHARP RECESSION. IN ADDITION, A FLEXIBLE EXCHANGE RATE SYSTEM DOES NOT IN ITSELF PROVIDE OR GUARANTEE ADEQUATE INTERNATIONAL LIQUIDITY. SOME FORM OF TRI-PARTITE BLOCK CURRENCY SYSTEM MIGHT BE A DISTINCT FUTURE POSSIBILITY, THE MAIN BLOCKS BEING THE YEN, DOLLAR AND EURO CURRENCIES.

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TOR WOULD HELP. IN MASSERA'S VIEW, THE DIFFICULTY IS THAT IN THE EVENT OF A FOREIGN EXCHANGE CRISIS, IT COULD BE SEVERE AND PROVOKE A SHARP RECESSION. IN ADDITION, A FLEXIBLE EXCHANGE RATE SYSTEM DOES NOT IN ITSELF PROVIDE OR GUARANTEE ADEQUATE INTERNATIONAL LIQUIDITY. SOME FORM OF TRI-PARTITE BLOCK CURRENCY SYSTEM MIGHT BE A DISTINCT FUTURE POSSIBILITY, THE MAIN BLOCKS BEING THE YEN, DOLLAR AND EURO CURRENCIES.

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3. SHAPUR SHIRAZI, VICE GOVERNOR OF BANK MARKAZI IRAN
ADDRESSED GROUP ON AN OIL COUNTRY CENTRAL BANKER'S VIEW
OF WORLD ECONOMY. EXCERPTS OF HIS ADDRESS INCLUDE:
QUOTE: . . . TO BEGIN WITH, THE ENERGY PROBLEM ITSELF
CONTINUES TO BE OF GREAT IMPORTANCE. WE SEE RELUCTANTLY
OIL BURNED FOR ENERGY AND, EVEN WORSE, WE SEE A LACK OF
UNDERSTANDING ON THE PART OF CONSUMERS. WE WOULD HAVE
EXPECTED THAT THE RESPECTIVE GOVERNMENTS WOULD HAVE DONE
THEIR UTMOST BY NOW TO EDUCATE THE PEOPLE ABOUT THE TRUTH
OF THE PROBLEM. THERE IS AT PRESENT, FOR EXAMPLE, A FEEL-
ING OF EUPHORIA THAT THE ENERGY PROBLEM HAS SUBSIDED AND
THIS EUPHORIA STEMS FROM THE FACT THAT PRODUCTION OF OIL
FROM NEW FIELDS OF ALASKA, NORTH SEA AND MEXICO AS WELL
AS THE LOW RATES OF ECONOMIC GROWTH IN THE WORLD HAVE
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CREATED A TEMPORARY GLUT IN THE SUPPLY OF OIL. ONE CAN
HARDLY EXAGGERATE THE DANGERS OF THIS WRONG IMPRESSION
FOR IT SERVES ONLY TO POSTPONE EFFORTS WHICH ARE URGENTLY
REQUIRED TO BRING ABOUT A RATIONAL SOLUTION TO THE ENERGY
REQUIREMENTS OF THE WORLD.

ANOTHER FALSE IMPRESSION SEEMS TO CENTER ON THE IDEA
THAT THE WORLD HAS FOUND A NEW STATE OF EQUILIBRIUM IN
EXTERNAL PAYMENTS. THE SURPLUSES OF THE OPEC COUNTRIES,
THEY SAY, ARE BEING RECYCLED THROUGH THE MARKET PLACE TO
BORROWERS IN NEED, AND THIS PROCESS IN ITSELF, THEY SAY,
HAS INSTITUTED A NEW STATE OF EQUILIBRIUM.

FEW PEOPLE REALISE HOW WRONG THIS ASSUMPTION IS AND HOW DANGEROUS IT IS TO LIVE UNDER THE AUSPICES OF SUCH AN ASSUMPTION. THE FACT REMAINS THAT THE RICH INDUSTRIALIZED COUNTRIES HAVE SUCCEEDED IN EQUILIBRATING THEIR BALANCE OF PAYMENTS WITH THE OIL PRODUCERS AND SOME OF THEM HAVE EVEN CREATED A SUBSTANTIAL SURPLUS IN THEIR EXTERNAL PAYMENTS. BUT THE WORLD'S LARGEST ECONOMY, U.S.A. AND THE WEAK INDUSTRIALIZED NATIONS, TOGETHER WITH THE REST OF THE UNDER-DEVELOPED WORLD, ARE STILL IN A DANGEROUS IMBALANCE WHICH UNDERMINES THE FINANCIAL STABILITY OF OUR SYSTEM.

I AS AN IRANIAN, ESPECIALLY IN MY PROFESSIONAL CAPACITY, WOULD HAVE LIKED TO SEE SOME ARRANGEMENTS UNDER WHICH BENEFITS ENJOYED BY THE STRONG INDUSTRIALIZED COUNTRIES RESULTING FROM SECURED AND RELATIVELY LOW PRICED PETROLEUM FROM OPEC MEMBERS WOULD HAVE BEEN PASSED ON, AT LEAST PARTIALLY, TO THE LESS PRIVILEGED SOCIETIES. I WOULD ALSO LIKE TO HAVE SEEN A GREATER DEGREE OF UNDERSTANDING BY THE INDUSTRIALIZED USERS ON THE ASPECTS OF THE ENERGY PROBLEM, INCLUDING ELIMINATION OF WASTE AND DEVELOPMENT OF ALTERNATIVE SOURCES. I WOULD LIKE TO HAVE SEEN A LARGE INVESTMENT DIRECTED TO OIL SUBSTITUTION INDUSTRIES SO THAT OIL COULD BE SAVED FOR MORE NOBLE USES.

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WE NOW GET THE FEELING THAT ANY BENEFIT DERIVED FROM THE SACRIFICE OF OUR DEPLETABLE RESOURCES GOES TO HELP SOME PRIVILEGED COUNTRIES BECOME STRONGER AND OTHERS TO MAINTAIN A GIVEN LEVEL OF CONSUMPTION THROUGH THE ACCUMULATION OF EXTERNAL DEBT.

... THE PRICE INCREASES OF 1973 HAVE CREATED FOR US AN ACCUMULATION OF FINANCIAL ASSETS. SOME OF THIS ADVANTAGE HAS BEEN IMMEDIATELY WIPED OUT BY A CONTINUING SHARP RISE IN THE PRICE OF THE COMMODITIES WE IMPORT EITHER FOR CONSUMPTION OR INVESTMENT IN OUR ECONOMY, AND THE BALANCE HAS STAYED IN THE FORM OF CLAIMS WITHIN THE FINANCIAL SYSTEM OF THE WESTERN WORLD. WE HAVE TRIED TO DO OUR UTMOST TO EXTEND DIRECT CREDITS TO SOME OF THE UNDER-PRIVILEGED COUNTRIES, AND IF YOU WILL EXAMINE THE RECORD YOU WILL FIND THAT CREDITS WE HAVE EXTENDED TO THIRD COUNTRIES, AS A PERCENTAGE OF OUR GNP, IS SEVERAL TIMES THE AVERAGE FOR OECD COUNTRIES.

BUT WHAT IS DISCOURAGING ABOVE ALL IS THAT OUR LIQUID MONETARY ASSETS ARE DEPOSITED WITHIN A SYSTEM WHICH IS NOW EXPOSED TO SO MANY DANGERS -- DANGERS WHICH ARE ERRONEOUSLY ATTRIBUTED TO THE SURPLUS OF THE OPEC COUNTRIES, DANGERS WHICH STEM BASICALLY FROM LACK OF DETERMINATION BY THE WESTERN WORLD TO REDUCE CONSUMPTION AND INVESTMENT AND FROM THE FAILURE OF THE UNITED STATES AND OTHER INDUSTRIALIZED COUNTRIES TO EMBARK UPON A COMPREHENSIVE ENERGY POLICY. WE DO NOT HIDE OUR FUNDS IN THE OIL WELLS:

WE RECYCLE THEM TO THE INDUSTRIALIZED COUNTRIES. WE CAN-
NOT INFLUENCE WHAT THEY DO WITH THEM. SO THEREFORE I DONOT SEE HOW WE
CAN BE BLAMED FOR DIRECTING OUR FUNDS TO
FINANCE CONSUMPTION RATHER THAN USE THEM FOR INVESTMENT.
CAN NOT THEY USE THESE FUNDS TO PROMOTE INVESTMENT AND
REDUCE THEIR UNEMPLOYMENT?

IT WOULD BE NEGLECTFUL OF ME IF I DID NOT SAY A FEW
WORDS ON HOW WE SEE THE PRESENT MONETARY SYSTEM OF THE
WORLD. THE FLAT ANSWER IS -- WE ARE SERIOUSLY WORRIED
ABOUT WHAT IS GOING ON. WE HAVE SEEN THE DESTRUCTION OF
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(C O R R E C T E D C O P Y) LINE 21 PREVIOUSLY OMMITTED

THE BRETTON WOODS REGIME, BUT WE HAVE SEEN NO EVIDENCE OF ANY SERIOUS EFFORT TO REPLACE IT WITH ANYTHING PRACTICAL. WE WERE TOLD THAT THE SDR WAS THE MOST MEANINGFUL REMUNERATION, ONLY TO SEE IT BEING EFFECTIVELY DESTROYED AND REPLACED BY THE DOLLAR STANDARD. NOW WE ARE SUDDENLY FACED WITH A VAST DETERIORATION IN THE CURRENCY WHICH IS SUPPOSED TO BE UNDERPINNING THE MONETARY STANDARDS OF THE WORLD.

WE ARE TOLD THAT THIS IS TOLERATED FOR THE SAKE OF CREATING A NEW STATE OF EQUILIBRIUM BETWEEN THE UNITED STATES AND ITS MAJOR TRADE PARTNERS, BUT I MUST ADMIT I DO NOT SEE HOW IT CAN HELP IN THIS DIRECTION IF THE TRADE DEFICITS OF THE UNITED STATES (INDUCED BY THE HUGE DEPENDENT) ARE OF SUCH MAGNITUDES THAT THEY CAN HARDLY BE CORRECTED BY ADJUSTMENTS IN THE RATES OF EXCHANGE. WE ONLY SEE ONE CURE IN THIS RESPECT AND THAT IS A STRONG AND MEANINGFUL ENERGY POLICY, ESPECIALLY IN THE UNITED STATES, AND WE ARE SORRY TO SAY THAT WE HAVE SEEN NO EVIDENCE THAT SUCH A POLICY IS FORTHCOMING.

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IN THE MEANTIME THE DETERIORATION OF THE DOLLAR COMBINED WITH HUGE TRADE DEFICITS OF THE UNITED STATES WILL RENDER TO WORLD LIQUIDITY A FAR GREATER DEGREE OF INSTABILITY THAN ANYTHING ELSE WE HAVE SEEN SO FAR. OPEC SURPLUSES ARE GROSS ITEMS, WHILE THE DEFICIT IN THE TRADE BALANCE OF THE UNITED STATES WILL BE A NET ADDITION TO WORLD LIQUIDITY. NO OPEC COUNTRY, OF COURSE, FEELS COMFORTABLE AT SEEING THEIR MONETARY RESERVES BEING ERODED BY THE CONSEQUENCE OF SUCH EVENTS.

WE ARE NOW IN A WORLD OF FLOATING EXCHANGE RATES, A SYSTEM WHICH WAS INTRODUCED TO HELP AUTOMATIC ADJUSTMENTS IN TRADE AND PAYMENTS DISPARITIES. BUT WE HAVE SEEN IT BEING MANAGED THE WAY IT SUITS INDIVIDUAL ECONOMIES FROM TIME TO TIME, AND WE HAVE ALSO SEEN IT BEING MANIPULATED TO COVER DOMESTIC POLITICAL WEAKNESSES. AS A RESULT THIS SYSTEM HAS HELPED TO FUEL INFLATIONARY PRESSURES IN VARIOUS ECONOMIES AND TO DISTORT FREE COMPETITION TO THE DETRIMENT OF CONSUMERS LIKE US.

FLUCTUATIONS IN THE DOLLAR RATES OF EXCHANGE FOR THE CURRENCIES OF THE GROUP OF TEN HAVE BEEN VERY LARGE, ERRATIC AND OFTEN EXCESSIVE (AS MUCH AS 20 PERCENT IN THE COURSE OF A FEW MONTHS) COMPARED WITH CHANGES IN UNDERLYING ECONOMIC CONDITIONS. EXCESSIVE FLUCTUATIONS IN EXCHANGE RATES ARE DISRUPTIVE TO WORLD TRADE. THE DIFFICULTY CAUSED TO TRADERS BY SUCH VOLATILITY IS NOT THE EX-

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CHANGE RISK -- THAT CAN BE COVERED BY FORWARD TRANS-ACTIONS. THE REAL DIFFICULTY IS THAT THE LARGE RISE AND FALL OF EXCHANGE RATES MAY AT ONE STAGE KEEP OUT IMPORTS THAT ARE BASED ON COMPARATIVE ADVANTAGE AND AT ANOTHER STAGE BRING IN IMPORTS THAT HAVE NO ECONOMIC JUSTIFICATION

ONE REASON FOR THE LACK OF CONFIDENCE IN CURRENCIES IS THAT GOVERNMENTS SEEM TO DISCLAIM ANY RESPONSIBILITY FOR THE BEHAVIOUR OF EXCHANGE RATES. IF THE MONETARY AUTHORITIES ARE INDIFFERENT TO THE EXCHANGE RATES FOR THEIR CURRENCIES, THE MARKET WILL CONCLUDE THAT THE FLUCTUATIONS WILL BE LARGE. THE MONETARY AUTHORITIES MUST CONVEY TO THE PUBLIC THAT THEY ARE CONCERNED ABOUT THE EXCHANGE RATES FOR THEIR CURRENCIES, AND THAT WHILE THEY WILL NOT PREVENT CHANGES IN EXCHANGE RATES THAT FACILITATE BALANCE OF PAYMENTS ADJUSTMENT, THEY WILL ACT TO MODERATE FLUCTUATIONS THAT BECOME EXCESSIVE. BECAUSE EVERY EXCHANGE RATE INVOLVES TWO OR MORE CURRENCIES, DECISIONS ON INTERVENTION SHOULD BE MADE THROUGH COLLABORATION OF THE INTERESTED COUNTRIES AND WITH THE PARTICIPATION OF THE INTERNATIONAL MONETARY FUND. AFTER ALL, THE FUND HAS BEEN GIVEN THE DUTY OF EXERCISING FIRM SURVEILLANCE OVER THE EXCHANGE RATE POLICIES OF ITS MEMBERS. END QUOTE.

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4. C.W. (KIT) MCMAHON, EXECUTIVE DIRECTOR OF BANK OF ENGLAND, QUESTIONED WHETHER THERE IS AN INTERNATIONAL MONETARY SYSTEM:

QUOTE ... THE ESSENCE OF ANY INTERNATIONAL MONETARY SYSTEM MUST BE THE EXISTENCE OF CONSTRAINTS ON SOVEREIGN BEHAVIOUR. IT MIGHT SEEM AT FIRST SIGHT THAT ONE SYSTEM FAVOURED BY MANY GROUPS OF ECONOMISTS--PURE FLOATING-- FAILS TO MEET THIS CRITERION. BUT A LITTLE REFLECTION SHOWS THJF THIS IS NOT SO. THE INTELLECTUAL CASE THAT PURE FLOATING MAXIMISES THE WORLD'S WELFARE MAY OR MAY NOT CONVINCE YOU. BUT THE ESSENTIAL POINT TO OPERATING A REGIME OF PURE FLOATING IS THAT ALL AUTHORITIES--AT LEAST ALL THE IMPORTANT ONES-- COMMIT THEMSELVES TO RE-
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FRAIN FROM ANY INTERVENTION IN THE EXCHANGE MARKETS (OR, PERHAPS, TO INTERVENE ONLY TO COUNTER DISORDERLY MARKET CONDITIONS). IN PRACTICE, THIS ESSENTIAL COMMITMENT TO PASSIVITY BY GOVERNMENTS AND CENTRAL BANKS IS SELDOM MADE EVEN IN PRINCIPLE; AND WHEN IT IS MADE IT IS SELDOM CARRIED OUT A OUTRANCE. PARADOXICALLY, THE CONSTRAINT WHICH FREE FLOATING IMPOSES IS SO SEVERE AS TO BE UNACCEP TABLE. HOWEVER, ONCE SUBSTANTIAL BUT UNPREDICTABLE AMOUNTS OF INTERVENTION ARE BEING CARRIED OUT, WE ARE IMMEDIATELY CARRIED A CRUCIAL DISTANCE FROM THE UNDERLYIN ECONOMIC PHILOSOPHY OF A FLOATING RATE SYSTEM.

IT IS IN PRACTICE EXTREMELY DIFFICULT TO GET ALL THE WORLD'S GOVERNMENTS TO AGREE ON ANY SET OF CONSTRAINTS ON THEIR BEHAVIOUR--AND THEN TO STICK BY THEIR COMMITMENTS WHEN THE GOING GETS ROUGH. FOR THIS REASON THE WORLD HAS PERHAPS ONLY TWICE HAD WHAT COULD PROPERLY BE DESCRIBED AS AN INTERNATIONAL MONETARY SYSTEM IN MODERN TIMES: THE GOLD STANDARD AND THE BRETTON WOODS SYSTEM. BOTH OF THESE MAY BE SAID TO HAVE WORKED EFFECTIVELY AS SYSTEMS FOR A CONSIDERABLE TIME, THOUGH BOTH HAD PERIODS OF DECADENCE DURING WHICH THEY CEASED TO WORK SATISFACTORILY, WHILE THEY WERE BREAKING UP.

...FOR BETTER OR WORSE, THEN, THE BRETTON WOODS SYSTEM BROKE DOWN AND THE WORLD MOVED, DESPITE SEVERAL REAR-

GUARD ATTEMPTS TO PREVENT IT, TO A REGIME OF VIRTUALLY TOTAL FLOATING. THE US BECAME INSTEAD OF (OR RATHER AS WELL AS) THE BANKER, ONE OF THE PARTICIPANTS. IN THE TERMS OF OUR EARLIER METAPHOR, INSTEAD OF A "POSITIVE SUM GAME" WE MOVED TO A "ZERO SUM GAME." EVERYBODY'S SURPLUS WAS NOW SOMEBODY ELSE'S DEFICIT. IT WILL BE CLEAR BY NOW THAT IN MY VIEW THIS STATE OF AFFAIRS, WHATEVER ITS APPARENT ECONOMIC ADVANTAGES, IS LIKELY TO INVOLVE RATHER SHARP POLICY CONFLICTS BETWEEN NATIONS. IT MAY BE POS -
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SIBLE TO CODIFY SOME RULES OF BEHAVIOUR FOR SUCH A SYSTEM (REMEMBERING THAT THE PARTICIPANTS ARE OF VERY UNEQUAL POWER, WHICH IS BOUND TO ADD TO THE DIFFICULTIES) AND INDEED ATTEMPTS HAVE BEEN MADE IN THE REFORMED IMF ARTICLE TO DO THIS. THOSE ATTEMPTS MIGHT BE THOUGHT TO ILLUSTRATE JUST HOW DIFFICULT IT IS TO DEVISE RULES WHICH ARE BOTH GENERALLY ACCEPTABLE AND HAVE SOME SIGNIFICANT INFLUENCE ON BEHAVIOUR. A PRIORI, ONE WOULD INDEED EXPECT MORE EXPLICIT CONFLICTS BETWEEN NATIONAL POLICIES AND THEREFORE MORE SELF-REGARDING AND GENERAL WELFARE-REDUCING ACTIONS TO BE TAKEN.

APART FROM THE EXPERIENCE OF THE '30'S, HOWEVER, WE HAVE LITTLE TO GO ON TO HELP US DECIDE WHETHER THIS VIEW OF FLOATING IS THE RIGHT ONE. THE WORLD HAD ONLY JUST EMBARKED ON THESE ARRANGEMENTS WHEN THE FINANCIAL EARTHQUAKE OF THE QUADRUPLING OF OIL PRICES OCCURRED.

SINCE THEN THERE HAS BEEN AN UNREQUITABLE SURPLUS IN ONE PART OF THE WORLD WITH A CORRESPONDING IRREMOVABLE DEFICIT SPREAD OVER THE REST. THE WORLD OUTSIDE OPEC HAS BEEN PLUNGED INTO A "NEGATIVE SUM GAME." INDIVIDUAL NATIONS, WITH NO DEFINED RULES FOR EXCHANGE RATE POLICY, OR INDEED, BALANCE OF PAYMENTS POLICY GENERALLY, HAVE BEEN COMPETING FOR AN OVERALL DEFICIT. IT IS NOT DIFFICULT TO SEE THE A PRIORI LIKELIHOOD THAT THIS WILL LEAD TO CUMULATIVE DEFLATION, NATIONAL RECRIMINATION AND PRESSURES FOR PROTECTIONISM.

IT IS EASY ENOUGH TO ANALYSE ACADEMICALLY THE CONSEQUENCES OF AN AGGREGATE, UNREQUITED SURPLUS IN ONE PART OF THE WORLD; AND TO SAY, AS THE WORLD'S FINANCIAL STATESMEN HAVE REPEATEDLY SAID, THAT THE OVERALL DEFICIT MUST FOR THE TIME BEING BE ACCEPTED. BUT IT IS EXTREMELY DIFFICULT ON ANY THEORETICAL GROUNDS TO DECIDE HOW THE DEFICITS SHOULD BE SHARED OUT; AND IN THE ABSENCE OF ANY INTERNATIONAL SOVEREIGN BODY WHICH CAN IMPOSE ITS WILL, IT HAS NOT BEEN POSSIBLE TO PRESS FOR ANY PARTICULAR PATTERN OF DEFICITS, HOWEVER ARBITRARY THAT WOULD IN ANY
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CASE HAVE BEEN.

SINCE INFLATION WAS EVERYWHERE ALREADY RUNNING AT HIGH AND DANGEROUS LEVELS AT THE TIME THE OIL PRICE ROSE, MOST COUNTRIES FELT FORCED SOONER OR LATER TO TAKE RESTRICTIVE MONETARY AND FISCAL MEASURES AS PART OF A COUNTER-INFLATIONARY POLICY. THIS WAS PROBABLY RIGHT--INDEED ESSENTIAL--BUT IT FURTHER BEDEVILLED THE AIM OF ACCEPTING THE AGGREGATE DEFICIT.

IN PRACTICE COUNTRIES DIFFERED IN THE TIMING AND EFFECTIVENESS OF THEIR DOMESTIC ANTI-INFLATIONARY POLICIES AND SOME COUNTRIES; REGARDLESS OF THE OVERALL PROBLEM, DECIDED IT WAS OF PARAMOUNT IMPORTANCE THAT THEY THEMSELVES SHOULD ADJUST QUICKLY SO AS NOT TO BE PUT IN THE INSECURE POSITION OF BEING IN DEFICIT.

THE RESULTS OF ALL THIS ARE PLAIN TO SEE. IMBALANCES

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WITHIN THE NON-OPEC WORLD AMONG THE MAJOR COUNTRIES HAVE ACTUALLY INCREASED, ADDING TO THE PRESSURES CAUSED BY THE OPEC SURPLUS ON THE REST OF THE WORLD, PARTICULARLY THE SMALLER INDUSTRIALISED AND THE DEVELOPING COUNTRIES. EXCHANGE RATES HAVE MOVED VERY WIDELY. RECENTLY, THE MOST STRIKING FLUCTUATIONS HAVE BEEN THOSE BETWEEN THE DOLLAR AND MOST OTHER MAJOR CURRENCIES, REFLECTING IN PART THE PRESENT LARGE SURPLUSES AND DEFICITS. BUT THERE HAS BEEN INSTABILITY ELSEWHERE TOO: IT IS DIFFICULT TO SEE THE UNDERLYING SIGNIFICANCE OF THE RISE OF 15 PERCENT IN THE VALUE OF THE SWISS FRANC IN RELATION TO THE DEUTSCHEMARK OVER THE PAST 5 MONTHS; OR TO UNDERSTAND WHAT KIND OF ADJUSTMENT IS BEING FOSTERED BY IT.

INFLATION, THOUGH EVERYWHERE BELOW ITS WORST LEVELS IS STILL ALMOST EVERYWHERE TOO HIGH. TOGETHER WITH THE INSTABILITY OF EXCHANGE RATES, IT CONTINUES TO ACT TO SAP THE CONFIDENCE OF CONSUMERS AND BUSINESSMEN ALIKE, EXACERBATING THE ALREADY SERIOUSLY DEPRESSED STATE OF ACTIVITY THROUGHOUT THE WORLD. NOT SURPRISINGLY THE PRESSURES FOR PROTECTIONISM ARE STEADILY GROWING.

PRETTY CLEARLY WE HAVE NOTHING THAT CAN BE CALLED AN INTERNATIONAL MONETARY SYSTEM AT PRESENT; THE SITUATION IS UNSTABLE AND FRAUGHT WITH CONSIDERABLE DANGER. IN WHAT DIRECTION SHOULD WE LOOK IN TRYING TO DETERMINE ANY STEPS WE MIGHT TAKE TOWARDS REESTABLISHING A SYSTEM -- OR SHORT OF THAT AT LEAST REDUCING THE POSSIBILITIES FOR DISHARMONY AND CONFLICT?

...IN THE ABSENCE OF ANY INTERNATIONAL SYSTEM THERE ARE NO UNIFORM RULES LAYING DOWN THE APPROPRIATE BEHAVIOUR FOR ALL COUNTRIES ALIKE. AND THERE IS NO GUARANTEE THAT THE FREE OPERATION OF MARKET FORCES WILL BE CONDUCIVE TO THE APPROPRIATE BEHAVIOUR OF INDIVIDUAL GOVERNMENTS AND

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THE DEVELOPMENT OF INDIVIDUAL ECONOMIES. NOR IS ANY ONE COUNTRY IN A POSITION TO DETERMINE THE OUTCOME FOR THE WORLD AS A WHOLE.

EACH COUNTRY, SEEING THE WORLD FROM ITS OWN STANDPOINT, MORE AWARE OF ITS OWN POLITICAL, SOCIAL AND STRUCTURAL ECONOMIC PROBLEMS THAN ITS CRITICS OUTSIDE, IS RELUCTANT TO ACT ALONE. THE INESCAPABLE CONCLUSION IS THAT THE MAJOR POWERS OF THE WORLD WILL HAVE TO FEEL THEIR WAY TOWARDS SOME COMMON AGREED SET OF POLICIES. IN

DOING SO, I AM CONFIDENT THAT IN DUE COURSE THEY WILL
CREATE A NEW SYSTEM.

IT WILL NOT, HOWEVER, BE THE SORT OF SYSTEM WHICH
CAN BE WRITTEN DOWN AS A SET OF RULES ON A BLANK PIECE OF
PAPER. IT MAY BE RELATIVELY UNCODIFIED AND IT MAY LOOK
UNTIDY. ITS ESSENCE WILL BE SOME FORM OF MUTUAL SHARING
BETWEEN MAJOR BUT UNEQUAL POWERS OF THE RESPONSIBILITIES
FOR ADJUSTMENT, FINANCE AND RESERVE CREATION FOR THE WORLD
AS A WHOLE. UNQUOTE

FULL TEXT OF ABOVE SENT TO SYVRUD, TREASURY.

DURING THE QUESTION AND ANSWER SESSION, MCMAHON, IN
A HYPOTHETICAL WAY, ALSO ACKNOWLEDGED THE POSSIBILITY
OF AN EVENTUAL TRI-PARTITE MONETARY BLOCK SYSTEM EVOLVING.

5. PRIVATE BANKERS WHO ADDRESSED THE CONFERENCE INCLUDED
DR. IRVING S. FRIEDMAN, SENIOR VICE PRESIDENT, INTERNATIONAL
OPERATIONS, CITIBANK, AND JOHN WILSON, DIRECTOR
OF ECONOMIC AND POLICY RESEARCH AT THE BANK OF AMERICA.
FRIEDMAN CONSIDERED INTERNATIONAL MONETARY SYSTEM HAS BE-
COME AN INTERNATIONAL CREDIT SYSTEM. HE SAW IMPROVEMENT
THROUGH THE 1974-77 PERIOD. SOVEREIGN RISK BORROWERS ARE
ANXIOUS TO MAINTAIN OR REESTABLISH CREDITWORTHINESS,
WHERE IT HAD DIMINISHED. ZAIRE IS THE TEST CASE. THE
BULK OF PRIVATE BANK LENDING TO LDCS IS TO PRODUCTIVE
SECTORS. REFINANCING AS DISTINCT FROM MORATORIA OR RE-
SCHEDULING IS A SIGN OF IMPROVED CREDITWORTHINESS. PRI-
VATE BANKS' LENDING PRACTICE IS ENTERING A NEW PHASE.
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TO TREASURY DEPT WASHDC
SECSTATE WASHDC 4104
INFO AMEMBASSY BONN
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RISKS AND DANGERS CANNOT BE IGNORED BUT THEY ARE MORE
REALISTICALLY BEING TAKEN INTO ACCOUNT.

LOOKING AHEAD, EXPANSION OF PRIVATE BANK LENDING
WILL CONTINUE, WITH AN INCREASE IN CAUTION AND PROFES-
SIONALISM. BORROWERS IN FOREIGN COUNTRIES RECOGNIZE
THE NEED TO RETAIN GOOD BORROWER STANDING. PRIVATE
BANKS THEMSELVES DIFFER IN LENDING PRACTICES AND THE EX-
POSURE THEY ARE WILLING TO TAKE, BASED IN PART ON THEIR
OWN EXPERIENCES. PRIVATE BANK LENDING IS DIFFERENT, HOW-
EVER, FROM GOVERNMENT LENDING IN THAT THERE IS A NEED
FOR PROMPT AND FULL SERVICING OF THE DEBT. RESCHEDULING
CANNOT BE CONSIDERED AS LIGHTLY AS IN THE CASE OF GOVERN-
MENT-TO-GOVERNMENT LENDING. PRIVATE BANK LENDING IS
DEFINITELY FAVORABLY INFLUENCED BY IMF STANDBYS. FINALLY
THERE IS A NEED FOR A MUCH LARGER IMF; THE FUND'S CUR-
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RENT RESOURCES ARE INADEQUATE TO PROVIDE THE SYSTEM WITH
THE DEGREE OF CONFIDENCE NEEDED.

6. WILSON OF THE BANK OF AMERICA ALSO CITED A CAUTION-
ARY MOOD THAT PREVAILS IN BANKING AND THE UNDERLYING
STRUCTURAL DIFFICULTIES IN MANY ADVANCED ECONOMIES. HE
SAW AN OVERALL LACK OF POLICY DIRECTION FROM MAJOR GOV-
ERNMENTS AND CITED THE ECONOMIC DEBATE BETWEEN THE U.S.
AND ITS MAJOR ECONOMIC ALLIES. BANKS ARE PAYING MORE AT-
TENTION TO ECONOMIC AND FINANCIAL ASSESSMENTS. THE BOA
IN MEASURING COUNTRY AND CREDIT RISK ATTEMPTS TO QUANTIFY
A "STABILITY MEASURE" OF A COUNTRY'S ECONOMIC PERFORMANCE
AND AN EXTERNAL DEBT SERVICING CAPACITY INDEX. OVERALL,
THE MORE REALISTIC APPRECIATION AND UNDERSTANDING OF THE
MACRO-PROBLEMS HAVE THEMSELVES BEEN POSITIVE ELEMENTS.

7. IN SEVERAL BRIEF PRIVATE CONVERSATIONS, COMMERCIAL
BANKERS CONTINUED TO BEWAIL LOW LOAN DEMAND FROM GOOD

BORROWERS, NARROWING MARGINS, LONGER MATURITIES AND REDUCED MANAGEMENT FEES. THEY ARE AWAITING A PICK-UP IN WORLD INDUSTRIAL ACTIVITY TO GIVE STIMULUS TO LOAN DEMAND. FAILING THIS, SOME CONSIDER THEY WILL BE HARD PRESSED TO MAINTAIN QUALITY OF EARNINGS AND LESS WELL PLACED TO FEND OFF DEMANDS FROM LESS ATTRACTIVE BORROWERS. INDEED, THEY ARE BEATING THE BUSHES LOOKING FOR GOOD BORROWERS, ESPECIALLY THOSE WHO HAVE NOT RECENTLY COME TO THE MARKET.

8. FRANCOIS-XAVIER ORTOLI, VICE PRESIDENT OF THE EUROPEAN COMMUNITIES, REPEATED FAMILIAR LINES THAT ECONOMIC AND MONETARY UNION IS STILL A FUNDAMENTAL EC OBJECTIVE AND THAT PROGRESS TOWARD EMU IS AT THE SAME TIME A MEANS OF COPING WITH THE ECONOMIC CRISIS. INDEED, THE POTENTIAL

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TIAL DILUTION OF THE COMMUNITY BY THE ADDITION OF GREECE, PORTUGAL AND SPAIN IS AN IMPORTANT CONSIDERATION MILITATING IN FAVOR OF FURTHER PROGRESS TOWARDS EMU. EVEN IF IT CANNOT BE DECREED TODAY, EMU IS STILL A RIGHT GOAL FOR TOMORROW. THE 5-YEAR PROGRAM SUBMITTED TO THE EUROPEAN COUNCIL IS DESIGNED TO LEAD TO UNION EVENTUALLY. IN THE INTERIM, THE COMMUNITY'S FUNDAMENTAL PROBLEMS INCLUDE THE NEED FOR A RETURN TO CONVERGENCE OF ECONOMIC POLICIES, MONETARY AND BUDGETARY, AS WELL AS COMPLETION OF A FULL COMMON MARKET WHICH ORTOLI CALLED "A PROTECTION AGAINST PROTECTIONISM". ANOTHER ELEMENT IS MODERNIZING AND ADAPTING THE COMMUNITY INDUSTRIAL STRUCTURES.

9. FOLLOWING ORTOLI'S PRESENTATION, MANFRIED LAHNSTEIN, SECRETARY OF STATE AT THE MINISTRY OF FINANCE IN BONN,

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GAVE WHAT MANY LISTENERS CONSIDERED A FAIRLY OBJECTIVE, ALBEIT PESSIMISTIC, VIEW ON THE POSSIBILITIES FOR INTEGRATION IN THE EC. INTEGRATION MUST PROCEED IN INTER-RELATED FIELDS -- INDUSTRIAL, AGRICULTURAL AND DEFENSE. IF INTEGRATION PROCEEDS HERE, THEN ADEQUATE POLITICAL AND ECONOMIC POLICIES WILL FOLLOW ON AS A MATTER OF COURSE. INTEGRATION REQUIRES SIMILARITIES. WITH THE PROSPECTIVE ENLARGEMENT, PERHAPS A TWO-TIER EC SYSTEM COULD BE CONSIDERED. COMPLETE INTEGRATION IS DESPERATELY UNREALISTIC. SUFFICIENT SIMILARITIES DO NOT EXIST. SOCIAL SITUATIONS ARE TOO DIFFERENT; THE POLITICAL CLIMATE IS TOO DIFFERENT. IF CRITICISM IS JUSTIFIED IT SHOULD BE AIMED AT GOVERNMENTS RATHER THAN AT THE EC COMMISSION. LAHNSTEIN FEARED A RESURGENCE OF PROTECTIONISM. THE SEARCH FOR SCAPEGOATS MUST BE AVOIDED AND THE JAPANESE UNCLASSIFIED

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SHOULD NOT BE SINGLED OUT. NEITHER SHOULD EXCESSIVE ATTENTION BE PAID ONLY TO CURRENT ACCOUNT BALANCES. IN ORDER TO STRENGTHEN COORDINATION OF ECONOMIC POLICIES A COORDINATED APPROACH IS NEEDED. THIS IMPLIES CLOSER COORDINATION OF CYCLICAL MONETARY AND BUDGETARY POLICY; QUICK SUCCESS IS NOT AT HAND.

10. COMMENT: THE ABOVE IS NOT AN EXHAUSTIVE REPORT OF ALL THE SPEECHES DURING THE 2-DAY SESSION, BUT COVERS ONLY THE HIGHLIGHTS. IT IS REPORTED TO GIVE READERS AN IDEA OF VIEWS EXPRESSED AT A MAJOR BANKING CONFERENCE. TREASURY REPRESENTATIVE REGRETS UNAVOIDABLE DELAY IN REPORTING.

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